

"Gross charges" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money whether paid in money or otherwise, including cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of materials used, labor or service costs or any other expense whatsoever. See 86 Ill. Adm. Code 495.100. (This is a GIL).

July 26, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated May 17, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

We are consultants to a company that utilizes a major long distance telecommunications carrier ('CARRIER'). On behalf of our client ('COMPANY') operating in Illinois, which desires to remain anonymous, we hereby submit a request for a General Information Letter, pursuant to 2 Ill. Admin. Code § 1200.120. We appreciate this guidance on an issue related to the Illinois Telecommunications Excise Tax Act (the 'ACT').

COMPANY is not the subject of an audit by the Department, nor is litigation to which COMPANY is a party pending with the Department.

FACTS

COMPANY utilizes CARRIER's long distance services pursuant to a contract in which it has committed to use CARRIER's services at a certain dollar volume level for a period of three years. CARRIER in turn has committed to deliver services at certain favorable rates for the same period. The rates are standard tariff rates that are discounted proportionate to the volume and term commitment made by COMPANY.

In addition to the monthly discounts, the contract also includes a provision that COMPANY would receive certain credits ('CREDITS') at specified periods of time.

The first of the CREDITS is referred to as a 'conversion credit'¹ This credit was given to COMPANY in the third month of the contract, in the

form of a credit memo mailed separately from the bill. COMPANY was instructed to simply subtract the credit amount from its payment on that month's bill.

In the month the credit memo was to be applied, the Illinois Telecommunications Excise Tax was computed on CARRIER's invoice based on discounted service and usage charges but without regard to the CARRIER CREDIT that was to be taken against it.

The second, third, and fourth CREDITS were received by COMPANY in subsequent months as specified in the contract. They were understood by COMPANY to be in the nature of signing bonuses.² These credits appeared directly on the bills, as opposed to being issued in the form of credit memos. They appeared on the bills below the tax line as a negative dollar value, the effect of which was to reduce the current amount due for that month. As in the case of the credit memo, the Illinois Telecommunication Excise Tax was applied on pre-credit charges.

COMPANY believes CARRIER overcharged the Illinois Telecommunications Excise Tax with respect to CREDITS and that a tax refund is due from CARRIER. CARRIER has communicated its position that the Illinois Excise Tax should be based upon the charge for services *before* credits are applied.

DISCUSSION

We understand that the Illinois Telecommunications Excise Tax Act (the 'ACT') imposes a tax upon the act or privilege of originating or receiving intrastate or interstate telecommunications by a person in Illinois at a rate of 7% of the gross charge for such telecommunications purchased at retail and billed to a service address in Illinois. Under the ACT, gross charges are defined as the amount paid for the act or privilege of originating or receiving telecommunications in Illinois and for all services and equipment provided, valued in money, whether paid in money or otherwise, including cash, *credits*, services and property of every kind or nature.

CARRIER's responses suggest that it associates the word 'credits' as used in the ACT with the CREDITS described above. According to CARRIER, CREDITS are to be *included* in gross charges, and therefore no tax refund is due COMPANY. Assuming that this is the line of reasoning that CARRIER intended, we would like to make several observations:

- (1) The word 'credits' as used in the ACT refers not to what might be furnished to the customer, but the reverse (what a customer might grant to its carrier). The context seems to address the possible payment arrangements ('cash, credits, services and

property of any kind') that could be fashioned to satisfy the customer's financial obligation to its telecommunications carrier in the event that a reciprocal business relationship existed and the customer wanted to issue a credit of its own. Understandably, this provision had to be incorporated into the ACT so that bartering arrangements and the like would not serve to reduce gross charges below the true value, in money, of the telecommunications services³. If this indeed is the intention of the ACT, then the word 'credits' in this portion of the ACT cannot be associated with CREDITS, since CREDITS were not issued by COMPANY, but by CARRIER.

(2) If CARRIER is correct in associating the word "credits" in the Act with CREDITS, then difficulties still remain with CARRIER's position. To argue that credits should be subject to tax and then to fail to acknowledge that tax on a credit would have to itself be a credit, i.e., a negative number, is to contradict logic, not to mention mathematical principles.

Whether the ACT's use of the word 'credits' refers to what might be furnished by a carrier, or to the type of credits which might be issued by a carrier's customer, the outcome should be the same, in our view. The ACT defines gross charges as the *amount paid* for telecommunications, valued in money. The amount paid was, in a sense, cash and CREDITS. To determine what the effect of a credit would be on determining the value, in money, of telecommunications, it is necessary to examine the source of the credit. CREDITS in the context of this contract were not issued in exchange for any goods or services provided by COMPANY to CARRIER. CREDITS were not purchased, traded for, or originated like barter currency stemming from another transaction.⁴ In the larger view, CREDITS have no monetary value of their own.

CREDITS in this context are simply the additive inverse of the quoted per minute price of telecommunications, being derived solely from a manipulation of per minute rates in the contract negotiations. (CARRIER has a degree of flexibility in building CREDITS into a negotiated contractual price, therefore, CREDITS are an integral component of the price for telecommunications services). If this is true, then the amount paid for telecommunications, valued in money, is clearly the usage charges, less discounts, less CREDITS. Gross charges must then be equated with *amount of the check that COMPANY wrote when they paid the invoice* that month. We believe that this is the simplest and most straightforward conclusion when weighing how to treat CREDITS under the ACT.

Whichever of the two interpretations of the word 'credit' in the ACT is deemed to be correct, it appears that the effect of CREDITS would be to reduce the pre-credit invoiced total to the true value of services in money. This amount would constitute gross charges for

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purposes of taxation per the ACT. For COMPANY, the value of the telecommunications service in money is the amount it actually ended up paying to satisfy its obligation to CARRIER.

CARRIER also argues that CREDITS are considered cash and are properly treated as cash. However, an essential difference exists between cash and the type of credits that are being discussed in this letter. Unlike cash, CREDITS did (do) not have monetary power or value in themselves. Company did not earn CREDITS in the marketplace, and has no power to sell or exchange CREDITS in the marketplace. The only use for CREDITS is as application against CARRIER's invoices. CARRIER's assertion that CREDITS are to be treated like cash ignores fundamental differences between cash and CREDITS.

CARRIER also maintains that CREDITS are not discounts, not being computed upon usage, and asserts that the ACT provides no 'exemption' from gross charges for such credited amounts.

It is true that CREDITS were a negotiated set amount, fixed before the service was to begin, and that discounts are generally a percentage of actual usage. However, whether a credit is (a) calculated upon actual usage or, (b) negotiated at the inception of the contract as a flat amount, the ACT makes no such distinction when defining gross charges. It should again be noted that credits such as those discussed here are generally viewed by all parties in a negotiation as a promotional tool, and that they simply have to be factored into the whole equation when determining the true price on the table. Invariably, companies purchasing telecommunications on term contracts are intent upon determining the actual, net per minute rate being offered, in order to compare among a number of bidders vying for the business. One-time or periodic credits would undoubtedly be considered, just like discounts, as integral components of a term contract when arriving at an 'applies to applies' cost comparison. This would be equally true whether the credit is labeled a conversion credit, an installation credit, incentive credit, a signing bonus, or any other sort of deduction from the eventual amount paid for telecommunications service⁵

Additionally, the fact that CREDITS were designated in the contract (which became a tariff filed with the FCC) argues that they are as much a component of price as the discounts designated within the contract. Therefore, it must be concluded that both discounts as well as CREDITS must all be taken into account when establishing 'the amount paid for originating or receiving telecommunications in Illinois state...'.

Please advise us how CREDITS as described in this letter should be treated when determining taxable base of COMPANY's telecommunications charges, and whether, in your opinion, COMPANY is due a refund of Illinois Telecommunications Excise Tax from CARRIER.

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If you have any questions or need additional information, I can be reached at #####. Thank you.

The Telecommunications Excise Tax Act, 35 ILCS 630/3 (1996 State Bar Edition), imposes a tax upon the act or privilege of originating or receiving intrastate or interstate telecommunications by a person in this State at the rate of 7% of the gross charges for such telecommunications purchased at retail from a retailer by such person. "Gross charges" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money whether paid in money or otherwise, including cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of materials used, labor or service costs or any other expense whatsoever. 35 ILCS 630/2(a). See also 86 Ill. Adm. Code 495.100, enclosed. "Amount paid" is defined as the amount charged to the taxpayer's service address in this State regardless of where such amount is billed or paid. 35 ILCS 630/2(b). As such, credits in the form of bonuses, such as signing bonuses and contract bonuses, are subject to Telecommunications Excise Tax.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Gina Roccaforte
Associate Counsel

GR:msk
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¹ The term 'conversion credit' is used in acknowledgement of the fact that it generally takes a large, multi-location customer several months to make the switch from one carrier to another, and this can be costly to a customer. On the date when a customer's contractual commitment to the old carrier ends, the old carrier's rates automatically revert back to standard tariff rates, without discounts. A significant expense is incurred in the months it takes a customer to achieve a full cutover to the new carrier. A conversion credit may be given by the new carrier to lessen the budget impact of that additional expense.

¹ In the telecommunications industry a 'signing bonus' or 'promotional credit' is a tool often used by telecommunications carriers in competitive bidding situations. We have surmised several uses for signing bonuses. One use may be to help obscure view the real 'bottom line' per minute rate from the public. Such credits complicate the calculation of the real negotiated per-minute rate, and the less these negotiated rates are common knowledge, the better off carriers are in negotiations with other customers. Another use may be the psychological appeal of receiving a rebate of a large sum of money all at once, as compared to a less appealing percentage rate reduction over time. Obviously, it is not lost on consumers (at least not on sophisticated consumers like large corporations) that with respect to these signing bonuses, conversion credits, rebates, etc., the true price of service has to incorporate all such special credits into the equation. In the case of the contractual arrangement which is the subject of this letter, COMPANY's understanding during the negotiations was that CREDITS were an integral component of pricing. In fact, COMPANY states that it communicated its preference to dispense with the second, third and fourth CREDITS and simply pay a lower per minute rate consistent with the value of the credits. However, according to COMPANY, CARRIER conveyed its desire to utilize such credits in the pricing arrangement (at which point COMPANY acquiesced since the true cost of service would be the about the same either way.)

¹ Apparently, the intention of the ACT here is to deter taxpayers from understating the market value of telecommunications service. Thus, it is market value that must be determined, as market value is equated with taxable base. Per the ACT, market value is simply to be determined by what is *actually paid*, valued in money. COMPANY was not taxed on what it paid for telecommunications, but what it was billed before CREDITS. In our opinion, this would argue for a refund of tax from CARRIER with respect to CREDITS.

¹ One of the primary objectives of tariffs is to make public disclosure of all terms of carrier-customer contracts, the key element of which is price. The contract referred to in this letter was a specialized tariff filed with the Federal Communications Commission. This means that there are no other terms, understandings, or arrangements apart from this contract. CREDITS then, being a key component of the contract, cannot be separated from the price of the telecommunications provided under the contract; neither do CREDITS have any value or effect on their own apart from the contract, notwithstanding CARRIER's assertions to the contrary.

⁵ A principle's logic can often be tested by applying extreme circumstances and then weighing the outcome. Suppose a carrier offers to provide \$5,000 in telecommunications service under an arrangement where carrier will bill client for \$100,000, and will concurrently provide a credit of \$95,000 which the customer will apply against the invoice. (This is not to infer that a carrier could legally do this under current tariff regulations.) CARRIER's interpretation of the ACT would mean that this customer would pay more for tax than service. (The customer's payment check would be for \$12,000, the sum of \$5,000 for telecommunications service and \$7,000 tax.) In our opinion, this hypothetical situation